Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Cogdill	Analyst:	Norm Catelli	Bill Number:	AB 2570
Related Bills:	See Legislative History	Telephone:	845-5117	Amended Date:	May 16, 2002
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Irrigation System Improvement Costs Credit

SUMMARY

This bill would create a tax credit for the cost of a farm irrigation system improvement that provides water conservation.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's staff, this bill is intended to reward agri-businesses for being good stewards of the land entrusted to them by utilizing the tax system to provide a tax benefit.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2002, and would be repealed by its own terms on January 1, 2007.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in a trade or business or as investment property. The property must have a useful life of more than one year and includes equipment, machinery, vehicles, and buildings, but excludes land. The property is then depreciated over its useful life (recovery period).

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's trade or business. Expenses related to water conservation qualify to the extent that they are ordinary and necessary business expenses and are not for the purchase of property with a useful life of more than one year.

Existing state law provides general rules that apply to the division of credits among two or more taxpayers, a husband and wife, and partners. State law also provides that any credit limitation applies at both the entity and individual taxpayer level, unless otherwise specified.

Existing state and federal laws allow taxpayers to use various credits against tax. Neither state nor federal laws currently have a tax credit similar to the one proposed by this bill.

Board Position:			Department Director	Date
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THIS BILL

This bill would allow all taxpayers that own or lease land to claim a tax credit equal to 25% of the costs of purchasing and installing an irrigation system improvement, not to exceed $150 per acre. The system must be used in a business for the production of farm income and result in water conservation or savings.

This provision would extensively define the term “irrigation system improvement” in terms of the types of qualifying equipment and the impact on water use. An irrigation system improvement would also be defined to include a physical improvement, an alteration of real property, or an installation of equipment certified to meet the bill’s criteria. All irrigation system improvements must be certified by a registered civil engineer or certified irrigation designer, who is independent of the taxpayer and the seller or provider of the physical improvement, alteration, or equipment.

The basis of the qualified equipment would be reduced by the amount of the allowable credit.

Any non-qualified use of the irrigation system improvement system within one year of the date placed in service would result in recapture of the credit allowed.

This bill would require FTB to report annually to the Legislature on the use of the credit.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would occur during the department’s normal annual update.

LEGISLATIVE HISTORY

SB 435 (Monteith; 2001/2002) would have allowed a 30% credit for the cost of farm irrigation system improvements, and allowed an election to deduct the costs of a water filter system. This bill was held in the Senate Revenue and Taxation Committee.

AB 1054 (Cogdill; 2001/2002) would have allowed a 50% credit for the cost of farm irrigation system improvements. This bill was held in the Assembly Revenue and Taxation Committee.

SB 1974 (Poochigian;1999/2000) would have allowed an unspecified credit for the cost of a water filter system. This bill was held in the Senate Revenue and Taxation Committee.

PROGRAM BACKGROUND

A similar tax credit for the purchase and installation of water irrigation systems expired on December 31, 1985. That credit, taken in the year of installation, was equal to the lesser of 10% of the cost or a maximum of $500 and was provided in addition to any other qualified deductions.

OTHER STATES’ INFORMATION

A review of *Florida, Illinois, New York, Massachusetts, Michigan, and Minnesota* tax laws found no comparable tax credits or deductions. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

Implementing this bill would occur during the department's normal annual update.

ECONOMIC IMPACT

Revenue Estimate

The revenue analysis is estimated to impact income tax revenue as shown in the following:

Revenue Impact of AB 2570 Tax Years Beginning On or After 1/1/2002 Enactment Assumed After June 30, 2002 $ Millions			
	2002-3	2003-4	2004-5
Revenue Impact	-15	-20	-25

Any changes in employment, personal income, or gross state product that could result from this measure are not considered.

Revenue Discussion

This bill is a combination of two similar proposals: AB 1054 of the 2001-2002 session as amended May 21, 2001, and SB 1521 of the 1999-2000 Session. The tax credit estimate can be summarized as follows for the first tax year: Total eligible costs ($120 million) × 25% credit × portion used (50%) = $15 million.

For the irrigation system improvement costs, the estimate was developed in several steps. Discussions with industry experts indicate that replacing existing systems as well as the incentive effect of this bill would induce about 200,000 acres of irrigated land in California to adopt water-saving systems or equipment. Following discussions with industry experts, the average cost per acre to install the equipment and improve the irrigation system was calculated at about $525 per acre for 2000. This figure was adjusted for inflation for subsequent years. The portion of credits that could be applied in any given year against available tax liabilities was estimated using tax returns that report farm income. It was assumed that unapplied carryover credits would be exhausted by the fourth year.

ARGUMENTS/POLICY CONCERNS

Because this provision requires an adjustment to basis, it would create a state and federal difference, thus increasing the complexity of tax return preparation. However, disallowing the adjustment would mean that the taxpayer would receive a double tax benefit with respect to the same expenses.

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